In short, the average channel rate plus mark-up formula will compensate operators for the use of their tier channels by the lessee. Moreover, it is not a double recovery because this payment, (in contrast to the subscriber payment) serves as a proxy for the opportunity costs that leasing imposes.

B. Leased Access Rate Averaging

In order to enable cable operators to negotiate **below** the above-described "average channel rate", the Commission should allow operators on a system-by-system basis to do an averaging of their leased access rates. The impact that a leased access program has on subscribers and rates depends on the programming being offered by the lessee. Therefore, an operator should have the right to charge different rates for leased access programs. Specifically, the Commission should allow an operator to negotiate below and above the average channel rate as long as the operator's various negotiated rates are, on average, equal to or below the average channel rate. For example, an operator might negotiate a rate with a leased access user who has minority, educational or local programming at a rate that is well below the average channel rate. The operator would then be allowed to concurrently or subsequently negotiate with another potential leased access user at a rate above the average channel rate as long as the average of the two is equal to or below the average channel rate.[62]

To allow this rate averaging procedure to work in the marketplace, the Commission should establish at least a six month negotiation period from the date of receipt of the first leased access request following the effective date of the Commission's new leased access rate rules. By

[62] In order to ensure that the rate averaging does not result in any individual rate being prohibitively high, the Commission could retain its current highest implicit fee as a ceiling for any individual leased access rate.

allowing for such a negotiation, cable operators will have sufficient time to evaluate various leased access programming requests and will be able to negotiate below the average channel rate for more valuable leased access programming. Because Section 612 specifically allows operators to consider content in setting their rates and allows operators to discriminate, the concept of rate averaging between leased access users based upon the harm or value the programming brings to the cable system is fully supported by the statute.

NCTA recognizes that the average channel rate proposal will result in a reduction of the leased access rates that are produced by the current highest implicit fee formula. Additionally, the rate averaging proposal discussed above will enable operators to negotiate leased access rates even below the average channel rate. Further, NCTA recognizes that lost opportunity costs are difficult to quantify, but nonetheless are of a magnitude that easily meet and likely exceed the average channel rate surrogate described in this proposal. NCTA does not believe that any leased access formula resulting in a rate below the above-described average channel rate plus markup could in any way be presumed compensatory.

IV. THE COMMISSION SHOULD PROTECT EXISTING PROGRAM NETWORKS AGAINST "BUMPING" BY LEASED ACCESS PROGRAMMERS AND PROVIDE AN APPROPRIATE TRANSITION

The Commission must recognize in changing its formula the real world effect that additional leasing will cause. The hard fact is that spare channel capacity remains in short supply. Cable systems serving more than two-thirds of the nation's subscribers have no excess channel capacity.[63] The imposition of must carry rules in the 1992 Cable Act forced cable operators to devote significant additional space on their lineups to over-the-air broadcast

[63] Turner Broadcasting System, Inc. v. FCC, 910 F. Supp. 734, 780 (D.D.C. 1995) (Williams, J., dissenting), cert. pending.

stations. In many cases, this required operators to remove existing program services in order to make room for little-watched broadcast stations. This forced channel realignment caused significant customer dissatisfaction and confusion.

The Further Notice is particularly troubling in its apparent premise that diverse program networks that subscribers enjoy must be sacrificed in order to make room for non-traditional program networks that are less valued by subscribers. The Further Notice fails to consider the effects that this displacement will have on consumer welfare in its proposal that operators "designate" those channels that they will take off and replace with leased access services. In many cases, this could mean six services must be thrown off to make space available for leased access.[64]

It is ironic indeed that the Commission took pains a little over a year ago to allow cable operators to add six new services to regulated tiers under its "going forward" regime, which the Commission concluded would add to the diversity of program offerings that consumers desire.[65] These are precisely the services that are in jeopardy of "designation" for elimination under leased access.

The abrupt imposition of a new, lower rate formula could lead to several ill effects. Contracts entered into against the backdrop of the existing leased access rules, as the Further Notice suggests,[66] entailed very different risks than those that would be faced if a new formula

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64 Nearly half of cable subscribers are served by systems with 54 or more channels. NCTA, Cable Television Developments (Spring 1996) at 11.

65 See, e.g., Separate Statement of Commissioner Ness at 2 (explaining that "[t]he 'going forward' order provides incentives to add new services to invigorate existing regulated tiers.").

66 Further Notice at ¶ 99.

were to be adopted. And viewers would face the prospect in the absence of a transition of finding programming that they like abruptly replaced with less desirable networks. System upgrades, particularly by small systems, could also be adversely affected by immediate imposition of a new rate regime. Immediate implementation of a new formula could create profound disincentives to upgrading a system to squeeze a few more channels out of existing plant. This is particularly the case for small systems with more limited channel capacity, which are struggling to compete against DBS offerings and other video providers with greater channel capacity.

When Congress adopted leased access requirements in 1984, it protected against precisely these disruptions to an operator's existing line-up. It provided that operators would not be required to remove any service being offered at that time, and stated only that operators "[s]hall make channel capacity available for commercial use as such capacity becomes available..."[67]

The Commission more recently in its Open Video Systems ("OVS") proceeding has proposed adopting a similar approach to making channels available.[68] The Commission acknowledged that "[r]equiring relinquishment of a provider's allotment of channels after it has made business plans and has begun providing service to customers is detrimental to the provider's business and disrupts service. Therefore, there is a strong public interest in establishing some level of certainty in providers' expectations with respect to their ability to

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[67] Section 612 (b) (1) (E).

[68] Report and Order and Notice of Proposed Rulemaking, Implementation of § 302 of the Telecommunications Act of 1996; Open Video Systems, CS Docket No. 96-46 (rel. March 11, 1996).

retain channel capacity once allocated, and in consumers' expectations of uninterrupted service."[69]

To protect against these anti-consumer effects, the Commission should not require operators to bump programmers to make room for lessees.[70] The Commission should consider a phase-in, even where bumping would not occur, that coincides with a significant expansion of cable channel capacity. Such an approach, coupled with the expected expansion of channel capacity that will accommodate lessees, will best serve the public interest.

V. THE RULES SHOULD NOT REQUIRE PLACEMENT WITHIN A TIER

The Notice tentatively concludes that "absent some compelling reason (such as technical considerations)...leased access programmers have the right to be placed on a tier, as opposed to being carried as a premium service."[71] The Commission further proposes that leased access programmers have a statutory right to have a "genuine outlet" for their programming, and that "[b]oth the BST (basic service tier) and the CPST (Cable Programming Service Tier) with the highest subscriber penetration qualify as genuine outlets because 'most subscribers actually use' them."[72] Both of these conclusions, however, are based on a misreading of the statute and the purpose of leased access. No channel placement requirements should be adopted.

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69 Id. at ¶ 25.

70 We also agree that in order to ameliorate the impact on subscribers, the Commission should not require operators to open up a new leased access channel to accommodate lessees if that lessee can reasonably be accommodated on an existing leased access channel. See Further Notice at ¶ 124.

71 Further Notice at ¶ 118 (footnote omitted).

72 Id., at ¶ 119.

First, as the Commission recognized when it first addressed this issue in 1993, Congress did not mandate specific tier location for leased access channels, and, unlike PEG and must carry channels, did not mandate their placement on basic tiers.[73] The Further Notice is incorrect, therefore, in assuming that, while silent on this issue, the statute intended to restrict operators' choices regarding leased access channel placement to the basic or CPS tier.

Mandated placement on a tier is also inconsistent with the purposes of leased access. Congress only mandated that operators make channel capacity for <u>use</u> by unaffiliated lessees. It imposed no obligation on operators to include that use within a package of its voluntarily-carried services, or to ensure the delivery of leased programming to all or most of its subscribers on behalf of the lessee.[74] In fact, Congress in 1984 made clear that in establishing price, terms and conditions for leased access use, an operator could consider "<u>[h]ow [a leased access service] will affect the marketing of the mix of existing services being offered by the cable operator to subscribers, as well as potential market fragmentation that might be created and any resulting impact that might have on subscriber or advertising revenues.</u>"[75] Given that these considerations may still be taken into effect, insertion of a leased channel into a mix of existing services is not something mandated by the statute.

The statute on its face also evidences a contrary view of channel placement insofar as it gives the Commission authority to determine rates charged by the operator to the lessee for the "billing...and for the collection of revenue from subscribers by the cable operator for such

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[73] First Report and Order at ¶ 498, 8 FCC Rcd. at 5939.

[74] 1984 House Report at 52.

[75] <u>Id</u>. at 51 (emphasis supplied)

use."[76] If Congress intended lessees to be carried within a tier from which they receive no subscriber payment, its concern with billing and collection would make little sense.[77]

Moreover, forcing operators to include lessees within their tier is biased in favor of infomercial services and shopping channels that do not rely on subscription fees, but seek instead to engage in the direct sales of items to, or solicit direct payments from, viewers.[78] In addition, requiring placement within a tier will lead to duplication of programming services. Cable operators in creating tiers seek to create a desirable package of services, taking into account the other services already existing on the tier. Individual lessees do not have the same incentives.[79] As EI explains, "Economic models of program selection indicate that there is likely to be more duplicative programming when there are multiple entities (e.g., the access lessees) determining program choice than when there is a single entity (e.g., the cable operator). This is because the cable operator is interested in increasing total cable subscribership whereas the

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[76] 47 U.S.C. § 532 (c)(4)(A)(i).

[77] The Commission bases its conclusion that leased access channels must be included in the basic or CPS tiers on language from the 1992 Senate Report. Further Notice at ¶ 118. That language provides that "[i]f programmers using these channels are placed on tiers that few subscribers access, the purpose of this provision is defeated. The FCC should ensure that these programmers are carried on channel locations that most subscribers actually use, while also considering the legitimate need of the cable operator to market its product." 1992 Senate Report at 79. But Congress could not have intended such a literal reading of this legislative history. Otherwise, if a leased access user wanted to provide service on a premium basis, and collect money directly from subscribers, it would be unable to do so under the Commission's view of the Senate language.

Congress did not define basic or CPS tiers to include leased access channels, which it clearly could have done in the context of the 1992 Act. There is no indication that it intended to guarantee leased access programmers subscribership in all or most cable homes.

[78] See EI at 15.

[79] Id.

individual lessees are interested only in subscribership to their channels."[80] Therefore, mandating provision of leased access within a tier will lead to subscriber dissatisfaction with their tier offering, and will increase the chances that leasing will lead to less, rather than more, diverse program offerings.

VI. MISCELLANEOUS PROVISIONS

A. A "First Come, First Served" Leasing Requirement Contravenes the Statute

The Further Notice tentatively concludes that operators must lease channel space on a "first come, first served" basis.[81] That clearly is not the intent of Congress, however, in adopting the leased access provisions, and will demonstrably injure cable operators.

A first-come, first-served requirement would conflict with Congress' determination to allow operators to establish price, terms and conditions that are discriminatory. As the House Report described, "nothing in these provisions is intended to impose a requirement on a cable operator that he make available on a non-discriminatory basis, channel capacity set aside for commercial use by unaffiliated persons."[82] A first-come, first-served requirement, however, would be the antithesis of this requirement. Operators presumably would be unable to exercise any of the statutory rights given them under the leased access provision to consider the nature of the programming and its effect on the operation of the cable system (or to take advantage of the statutory provision for use of channel capacity for minority and educational programming) in

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[80] Id.

[81] Further Notice at ¶ 128.

[82] 1984 House Report at 51. This is exactly opposite to the conclusion Congress reached with respect to OVS. 1996 Telecommunications Act, Section 653 (b) (1) (A).

making channel capacity available. Rather, channel space would have to go to the first person in line -- regardless of the proposed use of the system. The Act was not designed to operate in this fashion.

B. The Commission Should Not Lower the Part-time Rate

The Further Notice also seeks comment on whether the Commission should require operators to charge part-time leased access users a prorated portion of its new leased access formula. As described above the full-time leased access formula proposed by the Commission will yield entirely unreasonable rates. Any proportion of that formula would lead to even more absurd rates -- ranging from pennies to just a few dollars an hour.

While we disagree with the full-time rate calculation, apportioning that rate -- or any other full-time rate -- among part-time users makes even less sense. The use of leased channels on a part-time basis may still force operators to bump a channel of existing program services. The Commission cannot reasonably establish a system in which part-time users fail to adequately compensate operators for the loss of their ability to program a full-time channel. Certainly, a simple proration of a full-time formula would fail to provide adequate compensation in those circumstances.

Moreover, even under the existing HIF formula, the rates for leased access time may be so low that advertisers may find it less expensive to purchase leased access time than a commercial spot on cable. Cable television, moreover, can hardly be considered the sole outlet for many of the programs requesting part-time usage -- which typically consist of infomercials or local real estate services which otherwise may buy time on other media outlets. Operators should be permitted to charge commercially reasonable rates for part-time uses that reflect their competitors in this market.

C. The Commission Should Prohibit Resale of Commercial Leased Access Channels

The Further Notice also seeks comment on whether the rules "should permit leased access time to be resold by the lessee."[83] Resale is wholly inconsistent with the purpose of leased access, and should not be permitted by the Commission's rules.

The reason for this rulemaking in the first place is to establish a maximum reasonable rate for commercial leased access speakers -- not to force operators to give away channel capacity to middlemen, who can then turn around and profit on use of that capacity. The statute contemplates operators ceding capacity for use by a particular programmer. If that programmer can then sell its channel slot, an operator has not been permitted to take into account in establishing the price, terms and conditions for access to the system the nature of the service. In particular, allowing resale would ensure that operators would not enter into contracts for rates lower than the maximum permitted by the Commission's rules. An operator, for example, would be loathe to enter into an agreement with a non-profit organization for less than the maximum rate if that organization were able to then sell its rights to the channel to the highest bidder. Moreover, it can hardly be said that the Commission's rules establish a reasonable commercial rates if there is a business to be gained in reselling that space at a higher rate.

The leased access provisions were not designed to provide below market access to cable systems. Resale is a concept arising in the telephone context -- under circumstances that are

[83] Further Notice at ¶ 141.

inapplicable here. Resale was originally designed by the FCC in the 1960s as a way to test the validity of discounts (such as those offered in AT&T's Telpak offering) afforded to large users of telecommunications services by allowing customers other than large users to purchase bulk services and resell them. The goal was to use resale as a way to discipline pricing behavior that assumed, but did not demonstrate, large cost savings. More recently, resale has been applied to increase the number of competitors providing service (e.g., wireless resale) or to permit price and service competition to more specialized customers (e.g., interexchange resale). The 1996 Telecommunications Act also identifies resale to provide direct competition in local exchange service for nonfacilities-based competitors and to assist in the development of full facilities based competition by allowing facilities based carriers to "complete" local networks by purchasing and reselling the capacity of incumbent carriers.

None of these purposes apply here. There is no favoritism toward large users that requires the price discipline that resale afforded initially. Nor are leased access customers unable to afford to purchase small amounts of time -- indeed, part-time users have generally found no problems with leased access prices. Cable operators are not supposed to be converted into common carriers in the leased access context.[84] In short, there is no public policy benefit to allowing the sort of arbitrage implied by resale.

[84] 47 U.S.C. § 541 (c) ("Any cable system shall not be subject to regulation as a common carrier or utility by reason of providing any cable service.")

D. The Commission Should Not Mandate A Lower Rate for Non-Profit Lessees

The Further Notice seeks comment on whether preferential rates and set asides should be adopted for not-for-profit entities.[85] There is no statutory basis for giving special dispensation to not-for-profit lessees and the Commission should not adopt its proposal.

First, the statute already grants special, no cost access for certain users in the form of PEG access. Not-for-profit entities, therefore, can gain free access to cable systems on channels specifically set aside for this purpose. Leased access, in contrast, was designed to serve a different purpose -- to allow commercial arrangements for use of the system. While the legislative history evidences an intent to allow operators to price discriminate in favor of non-profit entities,[86] there is no authority for the Commission to mandate such discrimination.

Second, merely because an entity is considered "non-profit" does not mean that it lacks the financial wherewithal to pay for access at compensatory commercial rates. Non-profit status does not hinge on a particular entity's financial resources. A "not-for-profit" designation is simply too broad a category on which to hang judgments about the worthiness of the entity seeking access or its ability to pay full freight for access.

Finally, Congress has already created categories of favored users of leased access channels in § 612. There is no statutory basis for adding not-for-profit programmers to that list.[87]

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85 Further Notice at ¶¶ 111-115

86 1984 House Report at 51.

87 In any event, even for educational and minority programming, there is no evidence that Congress intended to force operators to charge lower rates (although operators certainly may choose to do so voluntarily.) There is no basis for reading such a preference for non-profit programmers into the statute.

In sum, cable operators may voluntarily lease channels to not-for-profit programmers at rates lower than the maximum reasonable rate (and, in fact, the rate averaging proposal described supra at 21 would permit operators flexibility to do so). But there is no legal authority for the Commission to require special treatment of leased access non-profit users.

CONCLUSION

The Commission should abandon its cost model. It will cause operators and programmers to subsidize leased access users, which was never the point of this provision of the Act. This in turn will force cable operators to remove program services that their customers enjoy, and in their place put on program services for which there is no market demand. These harmful effects on operators, programmers and their viewers will ill-serve the objective of program diversity, which was the original goal of Section 612 and which has been accomplished, in fact, by other program developments since 1984.

The Commission can address concerns about its existing formula without mandating a methodology that would result in these harms. By fine tuning its existing rate formula, the Commission can make its leased access rate rules more workable without these severe anti-consumer effects. The Commission also should ensure that consumers are protected against changes to their channel lineups by not adopting its proposal to force placement of leased access users only onto highly penetrated tiers of service, and by protecting existing networks against "bumping" by lessees.

Respectfully submitted,

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May 15, 1996

ATTACHMENT A

An Analysis of the Federal Communications Commission's Maximum Reasonable Leased Commercial Access Rate

May 15, 1996

The 1984 Cable Act established a commercial leased access requirement for cable operators. The intention of this requirement was to provide access to the channel capacity of certain cable systems by parties unaffiliated with the cable operator so that programmers could distribute video programming free of the editorial control of the cable operator.[1] The Act also provided that each cable system operator was to establish "the price, terms, and conditions of such use which are at least sufficient to assure that such use will not adversely affect the operation, financial condition, or market development of the cable system."[2] Subsequently, the 1992 Cable Act provided the Commission with the authority to determine the maximum reasonable rate that a cable operator may establish for leased commercial access use.[3]

The Commission adopted rules that base a cable system's maximum reasonable leased access rate ("the maximum rate") on an "implicit" fee paid by non-leased access program services that are being distributed by the system.[4] In March 1996, in response to petitions for reconsideration, the Commission released an *Order and Further Notice* clarifying its

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1 Cable Communications Policy Act of 1984, Pub. L. No. 98-549, 98 Stat. 2779 (1984), 47 U.S.C. § 521 *et seq.*

2 Communications Act, § 612(c)(1), 47 U.S.C. § 532(c)(1).

3 Communications Act, § 612(c)(4)(A)(i), 47 U.S.C. § 532(c)(4)(A)(i).

4 The Commission's rules governing commercial leased access are located at 47 C.F.R. §§76.701, 76.790, 76.791, 76.975 and 76.977.

regulations regarding the maximum rate.[5] At the same time, the Commission announced that it was re-examining its prior leased access rate regulations from an economic perspective to determine if the maximum rate established under those regulations was reasonable.[6]

In the *Notice*, the Commission tentatively concluded that the current formula used to establish the maximum rate is likely to overcompensate cable operators and does not sufficiently promote the goals underlying the leased access provisions.[7] The Commission proposed an alternative methodology for establishing the maximum rate, which it believes better promotes the goals of leased commercial access.[8] In the *Notice*, the Commission also solicited comments on its tentative conclusions regarding the current maximum rate formula and its proposal to modify the maximum rate formula.

This paper examines the Commission's conclusion that the maximum rate established by the current formula generates a windfall to cable operators, and finds that this conclusion is unsupported. In particular, the paper argues that one implication of the Commission's theory is that cable operators should actively be pursuing leased access programmers and attempting to replace non-leased access program services with leased access program services. Since all parties agree that this is not occurring, and that relatively little leased access capacity is

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5 *Order on Reconsideration of the First Report and Order and Further Notice of Proposed Rulemaking*, MM Docket No. 92-266, CS Docket No. 96-60, FCC 96-122, released March 29, 1996 (hereafter "*Notice*").

6 *Notice* at ¶ 6.

7 *Notice* at ¶ 7.

8 *Notice* at ¶ 9.

being used for leased access, it appears that there is a flaw in the Commission's reasoning. The paper examines where the flaw arises.

The paper also analyzes the Commission's proposed alternative methodology for establishing the maximum rate. The Commission purports to base its maximum rate formula on the opportunity costs imposed on a cable operator that are associated with carrying leased access programming, but the Commission's proposed methodology is flawed. While the Commission identifies several sources of opportunity costs, the Commission errs in assuming, without any support or analysis, that some of these costs, indeed likely the most significant costs, are zero. While this assumption simplifies the maximum rate calculation under the Commission's proposed formula, the assumption is unrealistic, as the Commission itself recognizes elsewhere in the *Notice*. The Commission's proposed formula produces a subsidy to leased commercial access programmers, and imposes costs on cable operators and cable subscribers.

The paper next discusses the Commission's decision that leased commercial access programmers have the right to request carriage on the basic service tier, or on the most popular cable programming service tier. This decision allows lessees to free ride on the marketing efforts of other cable networks, hinders the operators ability to coordinate the package of programming offered, affects the revenues of other cable networks on the tier, and may favor certain types of programmers.

Finally, the paper considers another methodology for establishing the maximum rate that was proposed in the reconsideration petitions. This proposed methodology sets the maximum rate at the average implicit fee rather than at the highest implicit fee. Since the current formula proxies the value of a channel to subscribers by the average subscriber rate per channel, it may be more appropriate to also use the average license fee (rather than the lowest license fee) in calculating the implicit fee. If the

Commission believes that the existing maximum rate formula yields a rate that is too high, the use of the average implicit fee may provide a desirable alternative.

Alleged Overcompensation under the Current Maximum Rate

In establishing regulations to implement the leased access provisions of the 1992 Cable Act the Commission adopted the highest implicit fee formula as the method to set maximum reasonable leased access rates. Under this formula, the maximum rate is the highest "implicit" fee paid by a non-leased access program service that is distributed by the cable operator. As defined by the Commission, the "implicit" fee for a channel is the price per channel each subscriber pays the operator minus the amount per subscriber the operator pays the programmer for the channel.[9] The highest implicit fee formula was intended to prevent existing programming services from migrating to leased access channels in a way that would not benefit subscribers or "diverse" entities seeking leased access.[10] The rate established by the implicit fee formula was not intended to recover any fees paid by or to the operator for services such as billing and collection, marketing, or studio services.[11]

In the *Notice*, the Commission re-examines the maximum rate rules and tentatively concludes that the highest implicit fee formula is likely to

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9 In the non-leased access context, cable system operators generally receive a payment from subscribers and pay contractual license fees to programmers for the channels the operators distribute. The differences between these dollar amounts are the implicit fees that programmers pay to have their services distributed to subscribers.

10 *Notice* at ¶ 15.

11 *Notice* at ¶ 17.

overcompensate cable operators and does not sufficiently promote the goals underlying the leased access provisions.[12] The Commission identifies what it feels are three flaws with using the highest implicit fee formula to set the maximum rate: (1) the highest implicit fee allows double recovery of subscriber revenues by the operator; (2) allowing the operator to charge the leased access programmer the highest implicit fee allows the operator to set a higher rate than it accepts on non-leased access channels; and, (3) the highest implicit fee is not based on the reasonable costs that leased access programming imposes on operators.

The first two of these three potential problems lead the Commission to conclude that cable operators are likely to be overcompensated for the use of leased access channels. The notion of cable operators receiving a windfall under the current rules is examined in this section of the paper. The third potential problem, not basing the maximum rate on reasonable costs, is discussed in the following section, which examines the Commission's proposed alternative methodology for establishing the maximum rate.

Before examining why the current formula for establishing the maximum rate does not allow for a double recovery, consider the behavioral implications of the Commission's theory. If cable operators really could achieve double recovery of subscriber revenues, or operating costs, under the current regulatory framework, and there were no other costs associated with carrying leased access programming, then one would expect to observe significant numbers of cable operators eager to engage in leased commercial access. Under the Commission's theory, by replacing a currently distributed cable network—one that charges the cable operator a license fee and that doesn't generate any local cable

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12 Notice at ¶ 7.

advertising revenues—with a leased commercial access channel a cable operator would be able to increase its profits. Indeed, under the Commission's theory, cable operators should be eager to take *less* than the maximum rate since they would cover all operating costs from subscriber fees and any leased access payment they receive would be a contribution to profit (provided that the leased access payment covers any incidental costs associated with leasing the channel, *e.g.*, billing and collection, marketing, or studio services).[13]

Hence, if the Commission's theory is correct, cable operators should be replacing cable networks with leased commercial access channels in order to increase their profits. Since that replacement is not occurring, the Commission's calculation of the costs and benefits associated with leased commercial access must overlook some costs.[14] To some extent, these overlooked costs are the very costs that the Commission later claims are too speculative to measure. These costs are the hidden costs of leased access, in particular the impact of leased access on subscribership and subscriber revenues.

The Commission's double recovery argument starts by observing that the service fee an operator is allowed to charge its subscribers under the Commission's current rate regulatory framework is sufficient to cover the costs of providing cable services. Therefore, the Commission reasons, since operating costs are already being recovered from subscribers, there is

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13 It is important to keep in mind throughout this analysis that the rate being established by the Commission's rules is a *maximum* rate, not a mandatory rate, and not necessarily the rate that will be charged. If cable operators find it more profitable to charge a rate less than the maximum rate they would charge such a rate.

14 Another possibility not explored in detail is that potential lessees are unable or unwilling to pay even the costs associated with the various services not intended

no need to recover any of these costs in the leased access fee. Hence, the Commission concludes that using the service fee as a basis of calculating the maximum leased access rate leads to double recovery of operating costs.[15]

The problem with the Commission's simple analysis is that it ignores other significant costs imposed on the cable operator that are associated with carrying leased access programming. By focusing solely on operating costs and ignoring the demand side, the Commission misses the cost imposed on subscribers, and thereby on the cable operator, of carrying less desirable programming.

The Commission's double recovery argument assumes that a cable operator will be able to generate the same amount of subscriber revenues when carrying leased access channels on the basic service tier ("BST") or on a cable programming service tier ("CPST") as the operator now generates from its current programming lineup. But to assume that the operator and the subscribers are indifferent between the leased access programming and the current programming is not correct. The current program lineup has more value to subscribers and to the operator than the lineup with the leased access programming. As noted above, if the leased access program was as highly valued by subscribers as some of the current programming, the operator could increase its profits by replacing

to be covered by the maximum rate, e.g., billing and collection, marketing, or studio services.

15 At a simplified "cost accounting" level, and under certain assumptions, the Commission is correct. If a cable operator justifies its subscriber rate by basing that rate on the costs of operating the cable system plus programming costs plus profit, and then if the leased access rate is also supposed to cover only the cost of operating the cable system, there is a double recovery of these operating costs. The problem with this analysis is that the leased access rate needs to cover costs other than the operating costs. The Commission's analysis is correct only if these other costs are zero, and, in which case, the leased access fee needs to cover no costs.

an existing cable network (and save the associated license fee) with a leased access channel (and obtain some positive payment) while maintaining the same level of subscriber revenues. In that case, it would be in the cable operator's interest to replace current programming with leased access programming. Since that is not occurring, cable subscribers and the cable operator must be worse off when the operator carries leased access programming.

One of the opportunity costs of carrying leased access programming is a reduction in current and potential subscriber revenues.[16] The leased access fee needs to cover this opportunity cost, lost subscriber revenues, and other opportunity costs. Therefore, there is not a double recovery of subscriber revenues.

One reason that more leased commercial access programming is not currently being provided is that the opportunity costs associated with leased access programming are such that it is not profitable for the cable operator to carry leased access programming at a rate that also makes it profitable for the potential lessee to offer the programming. It is likely that the current maximum rate is insufficient to compensate operators for the costs associated with displacing an existing programming service.

The Commission is correct in concluding that cable operators should not subsidize programmers who seek access to their system through the leased commercial access provisions. The Commission states that leased access programmers should not impose a financial burden on

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16 The reduction in current subscriber revenues can occur either because subscribers discontinue their cable service or because the operator has to lower tier rates in order to retain subscribers. Losing subscribers impacts not only the operator's revenues from tier services but possibly also the revenues from premium services. Potential subscriber revenues will be reduced because it will be more difficult to attract new subscribers and the penetration of the cable system will be slowed.

operators. If a leased commercial access programmer could profitably supply programming at a lease rate that did not impose a financial burden on the operator, the lessee would be carried under the existing maximum rate formula. Lowering the maximum rate may increase the number of leased access programs carried by a cable operator, but only at the cost of reducing the operator's profit below the level established by the Commission's rate regulation policies.

The Commission's Proposed Alternative Formula

In an attempt to correct the deficiencies that it believes are present in the current maximum rate formula, the Commission has proposed an alternative maximum rate formula. In the Commission's view, its proposed formula does not permit overcompensation and is a cost-based formula. A significant deficiency of the Commission's proposed formula, however, is that it excludes certain cost categories. These cost categories are excluded not so much because the Commission believes that these costs do not exist, but because the Commission finds these costs hard to measure.

Under the Commission's proposed methodology, the maximum rate depends on whether the cable operator is leasing its full statutory set-aside requirement. If the operator's full set-aside capacity is leased, the operator is allowed to negotiate market-based rates with its potential lessees. Alternatively, when the full set-aside capacity is not leased, the maximum rate is based on a formula that attempts to quantify the operator's costs associated with carrying the leased access program.

The Commission's formula allegedly allows the cable operator to recover the cost of operating the cable system and additional opportunity costs associated with carrying the leased access programming instead of other programming. The Commission believes that this will occur since in its view (1) subscriber revenue will be unchanged so the operator can continue to use subscriber revenues to offset the costs of the cable system, and (2) the leased access fee will cover any other costs, *e.g.*, billing and collection, marketing, studio services, or contract negotiations.

The Commission attempts to derive the maximum rate by considering certain costs associated with carrying a leased access program. The first component of the Commission's proposed cost formula is the cable system's operating costs. The Commission states that an operator would not need to calculate its operating costs for channels that are currently on programming tiers (or dark), but instead would use an amount representing the average subscriber revenue per channel as its operating costs per channel in calculating the cost formula.[17]

The second component of the Commission's cost formula, "net opportunity costs," includes certain costs and savings that the Commission believes an operator incurs by leasing a channel to the leased access programmer. The Commission has proposed certain costs or savings that may be taken into account when computing opportunity cost: 1) lost advertising revenues currently generated by a channel if that channel is bumped by a leased access channel; 2) lost commissions, if, for example, an operator were to bump a direct sales programmer from which the operator receives a percentage of the programmer's revenue; 3) savings in program license fees that an operator does not have to pay because the non-leased access programming is no longer being carried; and, 4) technical costs associated with carrying a leased access channel, for example, the costs of signal scrambling or trapping out a signal.

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[17] *Notice* at ¶ 77.